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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 115

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LANE-WELLS COMPANY, A CORPORATION, AND TECHNICAL
ENGINEERING CORPORATION

ON ~~PETITION FOR A~~ WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH
CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 47-85) is reported at 43 B. T. A. 463. The original opinion of the Circuit Court of Appeals was withdrawn and does not appear in the record. The opinion of the Circuit Court of Appeals on petition for rehearing (R. 277-283) is reported at 134 F. 2d 977.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 10, 1943 (R. 276-277). A

petition for rehearing was denied March 22, 1943 (R: 277). The petition for writ of certiorari was filed on June 22, 1943 and granted October 11, 1943. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer¹ filed corporate income tax returns on Form 1120 but did not file personal holding company returns on Form 1120H as specifically required by Treasury Regulations under statutory authority. The question presented is whether there was a "failure" to file a "return" within the meaning of Sections 276 (a) and 291 of the Revenue Acts of 1934 and 1936, and Section 406 of the Revenue Act of 1935, with the consequence that an assessment for personal holding company tax might be made at any time, and a 25% penalty was incurred.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 18-22.

STATEMENT

The Lane-Wells Company, a Delaware corporation, was organized in 1937 to take over the business of Technicraft Engineering Corporation and its affiliated companies. In 1937, following a re-

¹ Technicraft Engineering Corporation is the taxpayer. The Lane-Wells Company is liable as transferee.

organization in which Lane-Wells Company, of Delaware, acquired the stock of the Technicraft Corporation, the latter conveyed all its assets to the Delaware corporation and was dissolved. (R. 60-63.) It has been stipulated that Lane-Wells Company is liable as transferee for any taxes found due from the Technicraft Corporation. (R. 65).

For the years 1934, 1935, and 1936 Technicraft Corporation timely filed the usual corporation income tax returns on Form 1120 (R. 63). It did not file personal holding company surtax returns on Form 1120H for any of those years (R. 64).

Technicraft's 1934 corporate return showed gross income from royalties of \$27,125.23, deductions of \$11,392.24, and net income of \$15,732.99. Its 1935 return showed "gross profits where inventories are not an income determining factor" of \$69,577.19, a discount of \$13.90, a gross income of \$69,591.09, and after deductions a net income of \$48,028.20. Its 1936 return showed a gross income of \$148,527.82, consisting of \$822.01 interest, \$2,500 rents, and \$145,113.73 royalties, less a discount of \$92.08, and after deductions a net income of \$111,460.51. In these returns it stated its business variously as "engineering business," "engineering development," and "research and engineering". (R. 63-64.)

The Commissioner determined that the Technicraft Corporation was a personal holding com-

pany in the years in question (deriving more than 80% of its income from royalties) and asserted deficiencies accordingly, by notice dated June 1, 1939 (R. 32-45, 79). A corresponding notice of liability, of the same date, was given the Lane-Wells Company, as transferee (R. 16-20). The deficiency notice was within three years of the filing of the corporate return, on Form 1120, for the year 1936, but not within three years of the similar returns for the years 1935 and 1934 (R. 63, 278). The notice of liability given the Lane-Wells Company as transferee was within four years of the filing of the corporate return for 1935, but not of the return for 1934 (R. 63, 280).

Upon petitions by both respondents (R. 7-20, 24-45), the Board of Tax Appeals held that Technicraft was a personal holding company (R. 65-72), a matter not in controversy here, and that the deficiency notice was timely, as to the disputed years of 1934 and 1935, because failure to file the personal holding company surtax returns rendered inapplicable the requirement that assessment be made within three years after the return is filed (R. 78-84). The Board further upheld, as to each of the three years, the imposition of a 25% penalty for failure to file the personal holding company return (R. 84-85).

Upon consolidated appeals by both respondents (R. 262-264), the court below sustained the Board in its decision that the Technicraft Corporation

was a personal holding company (R. 281) but reversed its decision as to the timeliness of the deficiency notice, as to the years 1934 and 1935, and the imposition of the penalty as to each of the three years (R. 277-283).²

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the filing of corporate income tax returns on Form 1120 was sufficient to start the running of the period of limitations against assessment of personal holding company surtax.

(2) In holding that the filing of such returns prevented the imposition of the statutory penalty for failure to file personal holding company surtax returns on Form 1120H.

(3) In failing to give effect to the fact that the filing of returns on Form 1120H was specifically required.

(4) In failing to affirm the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

For our argument with respect to the penalty the Court is respectfully referred to our brief in

² However, despite the holding that the deficiency notice for 1935 against Technicraft was untimely, the court below gave effect to the additional year allowed for proceeding against transferees and held the Lane-Wells Company liable for this year (R. 280-281).

R. Simpson & Co. v. Commissioner, No. 1, October Term, 1943.

Section 351 (e) of Title IA of the Revenue Acts of 1934 and 1936 provides that *all* administrative provisions of law applicable to taxes imposed under Title I of the Acts be read into Title IA of the Acts and applied to the taxes imposed by that Title. Section 276 of Title I is an administrative provision and when read into Title IA, provides that in case of failure to file a return, *the* tax (i. e., the tax imposed by Title IA) may be assessed at any time. Taken in its proper context the return referred to can mean only the return of the tax imposed by Title IA. That tax is required to be returned separate and apart from any tax imposed by Title I. Therefore it is clear that if the particular return required by Treasury Regulations 86 and 94, Article 351-8, is not filed by a personal holding company, personal holding company surtaxes may be assessed without time limitation.

Nothing said in *Germantown Trust Co. v. Commissioner*, 309 U. S. 304, requires a different conclusion, for that was a case where the required information was filed on the wrong form and the taxpayer in that case was not required to file two returns. Here the Treasury Regulations required two returns, one for each tax, and the statute of limitations applies to each return separately. Accordingly the filing of only one return does not

start the running of the period of limitations as to assessment of both taxes.

In any event, the return which was filed did not contain all the information necessary to disclose a liability for the personal holding company tax. Accordingly, if it is ever appropriate to excuse the failure to file the holding company return on the ground that the return actually filed made a sufficient disclosure, the situation here would not warrant it.

ARGUMENT

Taxpayer's failure to file personal holding company returns prevented the running of the statute of limitations upon assessment and subjected taxpayer to penalties

The taxpayer is a "personal holding company," within the meaning of Section 351 of Title IA of the Revenue Acts of 1934 and 1936, but it filed no personal holding company returns for 1934, 1935, and 1936, the years here involved. However, it did file the ordinary income tax returns. Section 275 (a) of both Acts (Appendix, *infra*, p. 18) provides that the income taxes imposed by Title I shall be assessed within three years after the return is filed; Section 276 (a) of both Acts (Appendix, *infra*, pp. 18-19) provides that in case of a "failure to file a return" the tax may be assessed at any time. Section 291 of both Acts, and Section 406 of the Revenue Act of 1935 (Appendix, *infra*, pp. 19, 20), provide penalties for failure to file the

return required by Title I. Each of these sections, by virtue of Section 351 (c) of the Revenue Acts of 1934 and 1936, is made applicable to the personal holding company tax imposed by Title IA. The deficiency and liability notices for the years 1934, 1935, and 1936, related to the Title IA tax and were dated June 1, 1939 (R. 16, 32). It is our position, contrary to the decision of the court below, that the deficiency notice was timely as to Technicraft for the years 1934 and 1935; that the liability notice was timely as to the Lane-Wells Company, as transferee, for the year 1934; and that a twenty-five percent penalty was properly asserted as to each of the years 1934, 1935, and 1936.

A full presentation of our views concerning liability for the statutory penalty for failure to file a personal holding company return, on Form 1120H, is contained in our brief in *R. Simpson & Co. v. Commissioner*, No. 1, this Term. The petitioner in that case relied upon a conflict with the decision below. Our argument there is fully applicable here with but one exception, which requires brief comment. As pointed out in our *Simpson* brief (pp. 44-46), the penalty for failure to file the personal holding company return was mandatory for the years 1934 and 1935, but for 1936 could be lifted if it were shown that such failure was "due to reasonable cause and not due to wilful neglect." In the instant case the Board of Tax Appeals appears to have mistakenly assumed

that the penalty was mandatory for 1936 as well as the other years (R. 84-85). We think the record would not sustain a finding that the taxpayer here had "reasonable cause" for failing to file the personal holding company return for 1936, and we are not clear that either respondent would desire a remand on this question. However, in view of the fact that the Board does not seem to have expressly decided the point, we do not object, if respondents so request, to a remand to the Board for the limited purpose of reconsidering the imposition of the twenty-five percent penalty for the year 1936 only.

Our discussion in the *Simpson* brief is also pertinent in large part to the question of whether the filing by the taxpayer of the ordinary corporate income- and excess-profits-tax returns, on Form 1120, is sufficient to start the running of the three-year statute of limitations on assessment provided by Section 275 (a). At pages 29-33 of that brief we have examined the legislative background of the personal holding company tax provisions, which were incorporated under Title IA of the Revenue Act of 1934, and we have shown that Congress regarded this as a separate tax, requiring a separate return. We have also pointed out that the regulations explicitly require the filing of a separate return, on Form 1120H, for the personal holding company tax, and that until the decision of the circuit court of appeals below, this

requirement had uniformly been sustained by the lower courts. Section 351 (c) (Appendix, *infra*, p. 19) simply requires that the administrative provisions applicable to Title I taxes shall apply equally to the Title IA tax. In addition to Section 54 (a) and Section 62, discussed in the *Simpson* brief, Title I contains Section 275 (a) and Section 276 (a), referred to previously. It is these latter provisions which are involved in this discussion.

Applying Section 275 (a) to Title IA, it is as though it read:

The amount of personal holding company taxes imposed by this title shall be assessed within three years after the return was filed * * *

And Section 276 (a) is as though it explicitly provided:

In the case of * * * a failure to file a personal holding company return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

In applying the law in regard to the period of limitation upon assessment to the taxes imposed by Title IA, the Commissioner adopted the precise formulae that are dictated by the statute. His regulations in this respect are merely a clarifying statement of the law. They read (Appendix, *infra*, pp. 21-22):

The same provisions of law relating to the period of limitation for assessment and collection which govern the taxes imposed by Title I also apply to the surtax imposed under Title IA. However, since the surtax imposed under Title IA is a distinct and separate tax from those imposed under Title I, the making of a return under Title I will not start the period of limitation for assessment of the surtax imposed under Title IA. If the corporation subject to section 351 fails to make a return, the tax may be assessed at any time. * * * [Regulations 86 and 94, Article 351-8.]

In the present case the taxpayer was required to file an income- and excess-profits-tax return on Form 1120 and did so. The period of limitations for assessment of that tax started running from the date of the filing of the return applicable to that tax. But the taxpayer failed to file the additional return of the tax imposed by Title IA, on Form 1120H.

In view of the care taken by Congress to impose a separate and distinct tax upon personal holding companies and of the Commissioner's authoritative requirement for a separate and additional return, it would be an anomaly if the principles announced by the lower court in regard to the period of limitations against assessments are to be adhered to. Under the Ninth Circuit's interpretation of the statute the filing of a return for Title

I taxes would suffice in many cases, such as here, to bar the collection of the unreported personal holding company surtax. The burden of reporting tax liability is upon the taxpayer and should not be shifted to the Commissioner in the case of personal holding companies any more than in the case of an individual taxpayer. The holding that a corporate income-tax return is sufficient to start the period of limitations running and to avoid the penalty places a premium upon failure to file the required surtax return.

Taxpayers may thus ignore with impunity the requirement for filing personal holding company returns. If the Commissioner should ascertain the liability in time to make the assessment, delinquent taxpayers will have lost nothing by a failure to file Form 1120H. On the other hand, the delay caused by their failure may well result in postponing the ascertainment by the Commissioner until after the collection of the unreported tax is barred. Thus a statute designed to place a limit upon the assessment of additional amounts only after taxpayers have given notice by their returns that they belong to the taxable class, will become an instrument for avoiding all liability.

In cases of corporations which are taxable only under Title I no such premium exists. If no return of the tax imposed by that title is filed, the corporation may be assessed at any time. Not only will it be liable for the tax which it right-

fully owes, but also for the penalty for failure to report it. On the other hand, the personal holding company is declared by the Ninth Circuit to be protected by the operation of the statute of limitations and immune from the penalty provisions, so long as it fulfills its duty in regard to the return of its ordinary corporate taxes. No such chance of immunity from tax has been granted any other type of taxpayer and we respectfully submit that Congress has granted no such opportunity to personal holding companies. Section 351 clearly dictates that not only the penalty provisions of Title I taxes shall apply specifically to Title IA taxes, but that *all* provisions of law which apply to Title I taxes shall also apply to Title IA taxes.

The court below based its conclusion upon the decision of this Court in *Germantown Trust Co. v. Commissioner*, 309 U. S. 304, which is discussed in our *Simpson* brief (pp. 38, 40-43). We believe the situation here is not comparable to the *Germantown* case. There the taxpayer was liable for but one tax. By mistake it used the wrong form, but the tax could be computed from that form. In the instant case the taxpayer was liable for two distinct taxes. It filed a return for one tax but wholly failed to file the required return for the second tax. The return which it did file, on Form 1120, did not disclose that it was a personal holding company or permit of an accurate computation of that tax.

Under similar circumstances in which the "return" filed did not contain the data from which the tax might be computed, this Court has held that only a return which supplied the information in the prescribed manner would start the running of the period of limitations. *Florsheim Bros. Co. v. United States*, 280 U. S. 453. In that case a tentative return showing an estimate of taxes due was authorized by the Commissioner and filed by the taxpayer. It was nevertheless held to be no return, the Court saying (p. 460):

The burden of supplying by the return the information on which assessments were to be based was thus imposed upon the taxpayer. And, in providing that the period of limitation should begin on the date when the return was filed, rather than when it was due, the statute plainly manifested a purpose that the period was to commence only when the taxpayer had supplied this information in the prescribed manner.

The decisive fact is that in order to secure the information necessary for the imposition of the second tax, the personal holding company tax, the Commissioner required each person meeting the statutory conditions to file a second return. It is true that he might have required that the additional information necessary to the imposition of the second tax should be added to the income-tax return, but by virtue of the statute the choice was for the Commissioner to make, and since he did

not require that all the information be reported in a single return, taxpayers are not at liberty to report the information in that manner and ignore the requirement that a separate return be filed. The period of limitations was presumably selected in anticipation of the orderly receipt of the information by the Commissioner, and upon the assumption that taxpayers would comply with the regulations.

Form 1120 did not call for the same information as did Form 1120H. For instance, the latter form called for a statement of stock ownership during the last half of the taxable year;³ for contributions or gifts not deducted in computing Title I net income; for income tax paid to a foreign country or a United States possession not deducted in computing Title I net income; for dividends from personal holding companies; and for amounts used or set aside to retire indebtedness (the credit allowed by Section 351 (b) (2) (B) of

³ Taxpayer's return for 1934 (R. 189, 190-193) gave no indication whatever that at least 50% in value of the outstanding stock was owned by five (or less) individuals. The return filed for 1935 (R. 197, 198-202) showed merely the number of common shares owned by two officers of the company, but the return did not state the number of shares outstanding. Nor did the 1935 return in any way indicate that at least 80% of gross income was derived from royalties, dividends, interest, annuities, or gain from the sale of stocks or securities. The 1936 return (R. 205, 206-212), although listing income as from royalties, again gave no indication of stock ownership beyond the fact that the same two officers owned specified amounts of preferred stock.

Title IA was not the same as the credit provided in Section 26 (c) (2) of Title I).⁴

Assuming *arguendo* that sufficient information could be gleaned from Form 1120 to disclose liability for the personal holding company tax and to compute the tax for Form 1120H purposes, it is doubtful that a proper interpretation of the particular statute in question was intended to make the collection of the revenue depend upon such a casual disclosure. It is true in every case that the Commissioner is clothed with sufficient authority to ferret out tax liabilities without the taxpayer's cooperation. But this Court held in the *Florsheim* case, *supra*, (p. 463), that the existence of such authority was without significance. It is equally without significance here, for a positive

⁴The court below stated (R. 278) that the Board had found that the taxpayer's returns "showed all the facts necessary for the respondent [Commissioner] to compute the taxes as a personal holding company obligation." Footnote 2 of the opinion (R. 278) stated that the Board's "finding" was:

4. * * * Taxpayer's income and excess profits tax returns filed on Form 1120 made a full disclosure of its gross income and deductions and its resulting net income * * *

The "finding" so quoted does not appear in the Board's findings of fact or opinion but is taken from the fourth paragraph of the headnotes to the Board's decision (R. 49; 43 B. T. A., at p. 464). It clearly does not support the natural import of the court's statement—i. e., the "finding" does not carry with it the necessary implication that the taxpayer (1) disclosed it was a personal holding company, or (2) furnished information from which the personal holding company tax could be correctly computed.

duty to file an additional return was placed upon the taxpayer and it was given ample notice of that duty by the Form 1120 which it filed (R. 79).

In the light of the explicit language of the statute and the legislative history of Title IA of the Revenue Act of 1934, it seems clear that Article 351-8 of Treasury Regulations 86 and 94 is an accurate and valid statement of the requirements of the statutes in regard to the application of the period of limitations against assessment of personal holding company taxes. In general, what has been said as to the application of the penalty in the *Simpson* brief applies here. In practical effect, the consequence of the decision below will be to bar forever the collection, not only of a penalty, but of a tax itself which the taxpayer, contrary to the plainest mandate, has failed to disclose.

CONCLUSION

The decision of the court is incorrect, and should be reversed.

Respectfully submitted.

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DECEMBER 1943.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this title or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this title shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

SEC. 276. SAME-EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a pro-

ceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * *

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file a return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, 25 per centum of the tax shall be added to the tax, except that when a return is filed after such time and it is shown that the failure to file it was due to reasonable cause and not due to willful neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.⁵

* * * *

SEC. 351. SURTAX ON PERSONAL HOLDING COMPANIES.

* * * *

(c) *Administrative Provisions.*—All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I of this Act, shall insofar as not inconsistent with this section, be applicable in respect of the tax imposed by this section,

⁵ The computation of the percentage of penalty under this action was changed in a manner not material in the instant case by Section 406 of the Revenue Act of 1935, c. 829, 49 Stat. 1014.

except that the provisions of section 131 of that title shall not be applicable.

* * * *

The corresponding sections of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical except Section 291, which reads as follows:

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 291-1 (as amended by T. D. 5058, 1941-2 Cum. Bull. 156). *Addition to the tax in case of failure to file return.*—In case of failure to make and file a return required by Title I within the prescribed time, a certain percent of the amount of the tax

the tax is added to the tax unless failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. The amount to be added to the tax is 5 percent if the failure is for not more than 30 days, with an additional 5 percent for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 percent in the aggregate.

A taxpayer who wishes to avoid the addition to the tax for delinquency must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be filed with the collector, who, unless otherwise directed by the Commissioner, will forward the affidavit to the Commissioner, and, if the Commissioner determines that the delinquency was due to a reasonable cause, and not to willful neglect, the addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause.

If the addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

* * * * *

ART. 351-8. *Return and payment of tax.*—A separate return is required for the surtax imposed under section 351. Such return shall be made on Form 1120H. In the case of a personal holding company which is a domestic corporation, the return is required to be made within the time prescribed in section 53 and in the case of a foreign corporation within the time pre-

scribed in section 235. The tax shown by the corporation on its return must be paid in the case of a domestic corporation within the time prescribed in section 56 and in the case of a foreign corporation within the time prescribed in section 236. The same provisions of law relating to the period of limitation for assessment and collection which govern the taxes imposed by Title I also apply to the surtax imposed under Title IA. However, since the surtax imposed under Title IA is a distinct and separate tax from those imposed under Title I, the making of a return under Title I will not start the period of limitation for assessment of the surtax imposed under Title IA. If the corporation subject to section 351 fails to make a return, the tax may be assessed at any time. If the Commissioner finds a deficiency in respect of the tax imposed by section 351, he is required to follow the same procedure which applies to deficiencies in income tax under Title I. The penalties applicable to the income taxes imposed under Title I, as well as the provisions of Title I relating to interest and additions to the tax, also apply to the surtax imposed by section 351. The administrative provisions applicable to the surtax imposed by section 351 are not confined to those contained in Title I but embrace all administrative provisions of law which have any application to income taxes.

Articles 291-1 and 351-8 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, are identical with the above except that under Article 291-1 the penalty for failure to file the return on time was mandatory.